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CHARLES ELMORE C
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No. 36151.

In the

Supreme Court of the United States

October Term, 1931.

No. 337.

WESTERN DISTRIBUTING COMPANY, *Appellant*,

vs.

THE PUBLIC SERVICE COMMISSION OF THE STATE OF KANSAS ET AL.

Appeal from the District Court of the United States for the District of Kansas.

BRIEF ON BEHALF OF APPELLANT.

ROBERT D. GARVER,
Kansas City, Missouri,
ROBERT STONE,
Topeka, Kansas,
Solicitors for Appellant.

SMITH-GRIEVES, LAW PRINTERS, KANSAS CITY, MO.

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OCTOBER TERM, 1931

THE WESTERN DISTRIBUTING COMPANY,
A CORPORATION,
APPELLANT,

VS.

THE PUBLIC SERVICE COMMISSION OF THE STATE OF KANSAS AND J. W. GREENLEAF, CHAS. D. SHUKERS, AND C. H. MONTGOMERY, AND THE CITY OF ELDORADO, KANSAS, A MUNICIPAL CORPORATION,
APPELLEES.

JURISDICTIONAL STATEMENT.

ROBERT D. GARVER,
Kansas City, Missouri,
ROBERT STONE,
Topeka, Kansas,
Solicitors for Appellant.

JONES & [illegible], TOPEKA

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vs.

THE PUBLIC SERVICE COMMISSION OF THE STATE OF KANSAS ET AL.

BRIEF FOR APPELLANT.

Opinions of the Court Below.

The opinions of the Court below were not reported but appear in the record of this proceeding at pages 49, 50, 53 and 56, with the decree at page 42 and an opinion overruling the first motion to dismiss at page 8.

Paragraph 1 of Rule 12.

Paragraph 1 of Rule 12 has been complied with and this Court has held that it has jurisdiction to entertain the appeal.

STATEMENT OF THE CASE.

This is an appeal from an order and decree (R. 42) of a duly constituted three-judge statutory Court (in the District of Kansas) consisting of Orie L. Phillips, C. J., J. Foster Symes, D. J., and Richard J. Hopkins, D. J.

The decree denied the application of appellant for temporary injunction and dismissed the cause. The matter had been submitted upon the issues joined by the amended bill (R. 12) and the answer thereto (R. 27).

A motion for temporary injunction was filed (R. 2), due notices were served upon the Public Service Commission, the Governor and the Attorney General (R. 3) and the statutory court was convened. At the first session, May 19th, 1931, a motion to dismiss the bill was overruled with the understanding that an amended bill might be filed and the parties might stipulate as to relevant facts respecting the proceedings before the Commission (R. 6).

In the opinion overruling this motion (R. 8) the Court construed the Kansas statute respecting review of proceedings before the Public Service Commission (R. 9), cited a decision of the Kansas Supreme Court construing that statute (R. 11) and held that the statute did not provide an exclusive remedy and could not prevent plaintiff from obtaining a determination as to whether or not its rates are confiscatory, by a judicial tribunal upon its own independent judgment as to both law and facts, citing the Ben Avon case, 253 U. S. 287 (R. 11). From this ruling neither party appealed.

The hearing was continued until June 25th, 1931; an amended bill and answer were filed; certain facts respecting the hearing before the Commission were stipulated and affidavits were filed (R. 62-89).

The motion to dismiss the amended bill was renewed and the Court sustained the motion (R. 42) and made findings of fact (R. 43) and conclusions of law (R. 48).

There was no objection to any of the findings of fact but appellant requested an additional finding (VIIa, R. 45), which was refused, Phillips, C. J., dissenting (R. 47), to which refusal appellant objected and was allowed an exception (R. 45). To the decree which was filed on June 26th, 1931, appellant objected and was allowed exceptions (R. 42), and to each of the conclusions of law appellant also objected and was allowed exceptions (R. 49). On July 18th, 1931, appellant filed its petition for appeal (R. 59), which was allowed July 23rd, 1931 (R. 60); assignments of error were filed July 18th, 1931 (R. 60), and bond for appeal was filed and approved July 24th, 1931 (R. 62). A condensed statement of the evidence essential to a decision of the questions presented on appeal appears at pages 62 to 90, inclusive, of the record and a statement of the points relied upon by the appellant may be found in the record at page 90. Acknowledgment of service upon the appellees appears at record page 95.

History of Proceedings.

In order that the Court may more readily understand the proceedings had before the defendant Commission and the manner in which they were conducted by the plaintiff, we ask the indulgence of the Court in briefly outlining the situation which existed at the time of the hearing.

In the year 1916, and for some time prior thereto, The Kansas Natural Gas Company, The Wichita Natural Gas Company, The Quapaw Gas Company and other then existing units, each being a supply gas pipe line company, now combined in the Cities Service Gas Company, were all in financial difficulties and unable to render service. In that year the control of their capital stock was purchased by Cities Service Company. Prior to that time no subsidiary of Cities Service Company or company affiliated with it, through stock ownership or otherwise, had been engaged in the gas transportation business in Kansas and no distributing companies in Kansas were affiliated with Cities Service Company through stock ownership or otherwise other than The Western Distributing Company operating in El Dorado and a few small towns in that vicinity.

Years of litigation involving The Kansas Natural Gas Company and other companies followed, receivers were appointed and such companies were operated by the receivers until about the year 1922 when they were turned back to their respective officers. In the course of this receivership city gate rates to the various cities receiving their supply from the several pipe line companies above mentioned were changed and increased, resulting in a city gate rate of thirty-five cents (35c) established by the order of Judge Booth, then assigned to this Court for that case.

Several years of experience under this rate demonstrated its insufficiency and in 1922 the companies—at that time The Kansas Natural Gas Company and The Empire Natural Gas Company—applied to the Kansas Commission for an increase in rates. After a full investigation and valuation of the two systems by both the engineers for the companies and the engineers for the

Commission, an order was entered March 21st, 1923, increasing the rate from thirty-five cents (35c) to forty cents (40c), the Commission's order reciting:

> "(The Commission is of the opinion that it is not necessary to set forth special elements of value, for the reason that on the lowest valuation submitted to it by any of the witnesses in the case (including the Commission's engineer) the total amount for depreciation and return under a 35c rate in effect at present is less than 2%, which is obviously an insufficient and unreasonable return."

Under Sec. 66-115, R. S. of Kansas 1923, a rate so established is made *prima facie* reasonable.

At the time this order was issued no distributing companies were affiliated with Cities Service Company, with the exception of El Dorado and a few small towns in the vicinity thereof, the distributing companies in the cities which supplied the necessary market for the pipe line system being owned and operated by companies not associated with and actively antagonistic to the pipe line company.

Several years' experience under the forty cent (40c) rate demonstrated to the pipe line companies the fact that they could not continue to exist even on a forty cent (40c) rate and make the expenditures then and in the future to be required to procure a supply of gas from distant fields due to the exhaustion of the fields then connected unless control was acquired of the distributing companies in the major markets in order to increase the consumption of gas in such markets to such an extent as to justify the operation of the lines and the making of the required expenditures.

Many millions of dollars were spent by Cities Service Company in the next few years acquiring the capital

stock of the distributing companies at Wichita, Hutchinson, Newton, Pittsburg, Topeka, the two Kansas Citys the twenty-five towns comprising the Union Public Service Company group and in Missouri, Joplin, Webb City Carthage, Carterville, St. Joseph, Springfield and other cities.

Millions of additional capital were then thrown into the pipe line systems and lines extended to new fields in Oklahoma and Texas.

As a result of the affiliation of such distributing systems and the work done in encouraging the additional use of gas, the consumption in Wichita per customer per year was practically doubled, and the consumption in all other cities raised from 25 to 75 per cent. This increase in business, which could not have been procured without the cooperation of the distributing companies and the pipe line company, resulted in a market which made possible an adequate supply and justified the operation of the lines in a condition to render 100 per cent service.

In part due to the fact that the supply and distribution companies were affiliated in a common group no contracts were entered into between the several distributing companies and the supply company other than an oral day to day agreement, the companies being all left free to purchase gas, if offered, at any price less than the price established by the affiliated supply company, and such gas is now being purchased wherever offered and constitutes a substantial part of the supply for many towns connected to the pipe line system, such as Parsons and Cherryvale and the saving is passed on to the consumer.

In 1925 applications for reduced rates to ultimate domestic consumers were filed with the defendant Commission by the cities of Wichita, Hutchinson and Newton. These applications resulted in an order unsatisfacto

the distributing companies involved and litigation in the Kansas Shawnee County District Court followed. T. M. Lillard of the Shawnee County bar was appointed referee, numerous hearings were held and all the evidence introduced which either party desired. This litigation resulted in a permanent injunction against the Commission's order and in a finding that the city gate rate of forty cents (40c) was reasonable and that the charges made by Henry L. Doherty & Company and by The Gas Service Company were reasonable and proper. (Admitted Ans., Par. IX, R. 35.)

This case was appealed by the Commission and affirmed by the Supreme Court of Kansas June 9th, 1928, the opinion being reported in 126 Kansas 220.

While these three cases were pending undertermined in the Supreme Court of Kansas, the City of Wichita filed a second application with the defendant Commission, which resulted in its order of August 10th, 1928, in direct conflict with the decision of the Supreme Court handed down only two months previous.

Being dissatisfied with this order, The Wichita Gas Company filed an injunction proceeding in the District Court of the United States for the District of Kansas, in which proceeding J. D. M. Hamilton of the Shawnee County bar was appointed master and testimony was taken at great length over a period of a year or more. In this proceeding the principal issue contended for by the Commission was the unreasonableness of the forty cent (40c) gate rate. Evidence at greater length than in any other proceeding was introduced in an effort to satisfy the Commission, as well as the Court, of the reasonableness of the rate and end the constant criticism of it. The result of this proceeding was the order of said Court signed in September, 1930, by Honorable

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as court and counsel. But why should it take 'approximately a year' to secure a new hearing and order from the Public Service Commission after its prior order has been held confiscatory or non-compensatory? Why should it take more than half a day? All the facts will have already been ascertained. The data already gathered by the Commission and the facts established in court proving the old rates too low will be at hand, and an approximately correct rate can be deduced therefrom by a simple mathematical computation."

From what we have said and from the decisions we have quoted it must be apparent to the Court that appellant appeared before the Commission believing that it would abide by its solemn agreement made in open court and recited in the decision of the Court, and that it would not be asked to again and within four short months relitigate the entire valuation, financial experience and rates of the pipe line company.

Appellant accordingly introduced the decision of the Supreme Court of Kansas and the decision of the Federal Court as handed down by Judge McDermott.

On page 18 of defendants brief below it is stated: "It is true that these decisions were offered in evidence, but the record of the decisions was not offered." This record was subsequently introduced by the applicant, but when the statement was made by Mr. Steiger, attorney for the Commission, as appears from the record (R. 78), that he would object to its introduction, the offer was withdrawn, applicant appreciating that under the strict rules of evidence the record was not admissible over objection. All of this, however, becomes entirely immaterial in view of the fact that appellees, in their answer to the

amended bill of complaint, paragraph 13, page 38, of the record, allege:

> "It is admitted that the defendant Public Service Commission should and did take notice of the decision referred to *and the respective records,* but it is averred that the defendant City of El Dorado has and had no knowledge thereof." (City was not a party before the Commission.)

In addition to the decisions of the two courts appellant introduced the evidence shown in Finding XI (R. 46), and, in its opinion, established a *prima facie* case, as to the reasonableness of the city gate rate.

Had it not been for the decision in the case of *Smith* v. *Illinois Bell Telephone Company,* there is no question but that the Commission would likewise have considered the showing made sufficient. In regard to its promise to abide by the decision of the Federal Court, appellees say in their brief below, page 18:

> "That was perhaps true, so far as the opinion of both parties existed with reference to the then existing law. * * * Since that time the courts have presented a different theory of the law (*Smith* v. *Illinois Bell Telephone Company*) and in attempting to find the cost of furnishing gas and the rate of return earned by the holding company the Commission is abiding by the latest decision of the Federal Supreme Court."

There is no question but that the Commission and its attorneys, had the Smith case not then been decided, would not have required a relitigation of the reasonableness of the city gate rate. On page 21 of their brief

below they reiterate the promise made in court in the proceedings before Judge McDermott, for they state:

> "This information once obtained and properly made in exhibit form could be used in each of the cities under the control of the distributing companies, and so far as time and financial output is concerned, their introduction in separate cases would not consume fifteen minutes."

And again:

> "The Commission will be satisfied once a complete investigation of the pipe line company is made and the books of the company audited, and it will be willing to take the gate rate found after such investigation and use it as a starting point for future rate cases."

The above is quoted to show the state of mind of the Commission then and now in regard to not requiring a continued relitigation of matters once adjudicated. This language, however, is all meaningless if the Commission insists on an application of the Smith case, for in that case the court held as to the dealings between the Chicago Company and the Western Electric Company that it was not sufficient to show over-all experience and remanded the case for an express showing as to the cost of service rendered Chicago as distinct and separate from all other cities in the Bell system. An application of this rule would mean that in every rate case the cost of gas at the city gate of every city distinct from all others should be shown.

The motion of the Commission's attorney to dismiss the proceeding was based entirely upon the Smith case and the objection to the introduction of the record in the

former cases was likewise based thereon. In other words, *had it not been for the decision in the Smith case the Commission would have accepted Judge McDermott's decision as a starting point and would not have dismissed the proceeding.* Now, while admitting that previous to the Smith decision the Commission had no jurisdiction or authority over the pipe line gate rate (page 18 of brief below) the defendants state that while they are not "in any way attempting to fix a pipe line rate which the pipe line company must charge but only to determine what the affiliated company should be allowed to charge to its expense item in determining a proper rate for the distributing plant," they are undertaking to do indirectly what they admit they could not do were it not for the Smith decision.

It must be borne in mind that the Commission was not at this time contending that the pipe line company was making an excessive return under the forty cent (40c) city gate rate, but was contending that under the Smith case the distributing company, by reason of its affiliation with the pipe line company, must show not the over-all experience of the pipe line company and the reasonableness of its return as to all its business, *but the cost of serving gas to the City of El Dorado independent of any other city or market on its line.*

As the motion to dismiss was the sole basis for the action of the Commission in dismissing appellant's application and denying it relief, we quote it in full (R. 74, 77):

> "May it please the Commission, at this time the attorneys for the Commission desire to present a matter to the Commission which has never been presented in like manner in my experience with the Commission, or has it ever been presented in like

form in the past, so far as my knowledge and experience goes.

Very recently there was a very important decision handed down by our Supreme Court, and the Supreme Court, in speaking through its chief justice, has apparently, using the common everyday language, made a new law; that it departed to a great extent from their decisions and rulings heretofore made in rate matters. They have apparently taken into consideration other necessary facts which can be determined, and upon which there must be competent testimony to determine, into consideration. Now, that has never, in the history of our Supreme Court, been taken into consideration in prior proceedings, and just recently, in a Supreme Court decision handed down by, I think, Chief Justice Hughes—although I am not certain as to that—the advance sheets of which have not been published, but only generally speaking, the decision in the Florida case, which I refer to from information at hand, is apparently of very far-reaching importance, just decided within the last three or four days; it is one which Mr. Benton communicated with us about. I mention it only as incidental to what I desire to take up and only for the purpose of stating that apparently the Supreme Court of the United States is getting back now more and more to the law applicable to state regulation, wherein it is possible for the state commissions to function.

I want to briefly read from the Illinois case; that is the case we are familiar with, to a certain extent. I will read from the syllabi first.

Mr. Garver: I think you should make your motion and argue it afterwards, rather than make the argument in the motion.

Mr. Steiger: Sometimes one lawyer does things differently from what some other would do, and you, perhaps, would go at it right, and make your motion first; I, perhaps, am going at it in the wrong way and making my statement first.

(Here Mr. Steiger read from the decision referred to.)

And in this connection I want the Commission to keep in mind the same identical set-up of companies involved in the Illinois telephone litigation, such as parent company and subsidiary companies, has the same identical set-up in this case, except in the telephone case it is a matter of sale of telephone appliances and in this instant case it is the matter of selling gas, same interlocking system of subsidiary companies existing under both of these proceedings.

(Continues reading from the decision.)

In other words, in the language of Chief Justice Hughes, the State Commission, in determining the fair basis of rate in the Illinois case, did not take into consideration at all as to the fairness of the price purchased from the Western Electric Company upon the telephones used:

On the record in this suit, the court concluded that the city had failed to support its contention that these prices were exorbitant. The court said that it appeared that for the past fourteen years the average profit of the Western Electric Company on its total business had not been 'In excess of seven per cent and never above ten per cent.'

Mr. Adams, in his testimony, stated to this Commission that he did not know, and did not claim to know what the profits or earnings were of the Cities Service Gas Company, because that is a company of which he had no knowledge or control, and was not furnished with that information.

(Continues reading from the decision.)

In other words, the Supreme Court has directed the lower court to make findings as I have read to you.

There is absolutely nothing in this evidence upon which you can predicate an order that the gas at the city gate is fair and reasonable, and there is no evidence at all showing any cost of that service to

the Western Distributing Company, which the Supreme Court has directed the lower court to ascertain in the Illinois Bell Telephone case.

Now I picked up a little magazine published by the General Utilities Association. I think it is a very fair magazine. On the front page of it, it says this:

(He then reads from the magazine.)

That, up until this Illinois decision was the law of the land affecting public utility rate questions. Now, here is what they say:

'But in this latest case, the court, holding that the companies were all parts of one integrated system, recognizes a new element. It holds that the cost of rendering the service, or of manufacturing the article, by the parent or affiliated company, is a factor which must have consideration.'

And there is no evidence, if the Commission please, in this proceeding at all, as to the cost of the services rendered by the Doherty Company nor the cost of the services rendered by the Gas Service Company or the reasonableness, or justness of any cost which they may make. Now, in conclusion, this article concludes:

'It is readily seen that the distinction between the two tests is a real one, and that it may have far-reaching consequences in its application to similar corporate relationships.'

So, therefore, for the reasons stated, and without reiteration, I move, and on behalf of your legal department, Mr. Hatcher and I are in entire accord in our procedure, move that the application of the Western Distributing Company for an increase in rates to the gas consumers in the City of Eldorado be denied."

Being dissatisfied with the refusal of the Commission to grant relief from most apparent confiscation appellant filed its bill in the court below, alleging with great

particularity the proceedings before the Commission, the value of appellant's property and its failure for many years to earn even operating expenses with nothing whatever for return and depreciation. It asked the court to exercise its independent judgment as to both the law and the facts and to grant relief from the confiscation of its property, which appellant had been suffering for many years (R. 12).

The appellees filed a motion to dismiss the bill and to deny relief on the ground that appellant had failed to make a proper showing before the Commission as to the reasonableness of the price it was paying the Cities Service Gas Company, affiliated with it through stock ownership, for gas at the city gate and had also refused to satisfy the Commission as to two items of its operating expense, one item being the sum of $3,454.43 paid to Henry L. Doherty & Company and the other an item of $5,970.11 paid to The Gas Service Company. The last two items are immaterial to the consideration of this case, as will be hereinafter pointed out, appellant having at all times, through the proceedings before the Commission and the court below, offered to eliminate these items if the Commission or the court were not entirely satisfied with their reasonableness.

The court declined to pass on the motion of appellees to dismiss for the reason that it alleged facts not appearing on the face of the bill and required appellees to raise the issue by answer. This was done and on the issues raised by the bill and admitted by the answer the court below concluded that appellant had not exhausted its administrative remedy before the Commission and denied it relief.

The court below found that appellant had made its case before the Commission except as to the reason-

ableness of the price it was paying for gas at the city gate and the payments made to Henry L. Doherty & Company and The Gas Service Company and also found that the last two items could be eliminated without affecting appellant's right to relief.

Findings IX, X, XI and XII (R. 46-47) are as follows:

IX.

"Said application was duly heard by said defendant Commission, at which time it is admitted by the parties hereto that applicant's evidence was sufficient to make a *prima facie* case upon all issues except as to three items of its operating expenses, to-wit:

1. A payment of $3,454.43, being 1¼% of its gross revenue, paid to Henry L. Doherty & Company.

2. The sum of $5,970.11 paid to the Gas Service Company.

3. The cost of gas purchased from the Cities Service Gas Company at a total cost of $176,260.3., under the above mentioned city gate rate.

X.

Assuming that the rate at the city gate is reasonable, Items 1 and 2 of Finding IX could be eliminated without affecting plaintiff's right to relief and would not be necessary to a determination of the question here presented, for the reason that under the showing made by the plaintiff it is failing to make its operating expenses by an amount greatly in excess of the total of said items.

XI.

As to Item 3 of Finding IX, cost of gas at the city gate, plaintiff introduced in evidence before the Commission the decision of the Supreme Court of

Kansas and the decision of this court hereinabove referred to; and other evidence tending to show that there was no other source of supply than that of the Cities Service Gas Company; that no gas had ever been offered at a cheaper rate; that the plaintiff would have purchased cheaper gas if offered by any other company; that the cost of bringing gas to the city gate had not altered greatly for quite a few years; that there had been no change in the city gate rate since 1923; that there had been no material change in the situation since the decision of the Supreme Court of Kansas and of this court above referred to; that all cities on the Cities Service Gas Company system receive their supply from a common source; that the price is the same as to all cities not having local gas; that an effort was made to find local gas available to Eldorado but none was found; that at the time the 40-cent gate rate was established all the larger distributing companies, such as the two Kansas Citys, Topeka, Wichita, Hutchinson and Newton, were not owned or in any manner affiliated with the Cities Service Gas Company; that no change has been made in the city gate rate since the properties in those cities were acquired, and that the properties at Lawrence, Leavenworth, Atchison and other towns are now owned by outside interests and pay 40 cents at the city gate the same as affiliated companies. Plaintiff refused to introduce evidence or make any showing as to the cost of gas to the Cities Service Gas Company at the city gate of Eldorado, Kansas, and refused to offer any testimony to show whether or not the Cities Service Gas Company was making an excessive or undue profit on gas sold to the plaintiff other than the adjudications hereinbefore referred to.

George T. McDermott, who was District Judge at the time the proceedings were commenced and tried, but a Judge of the Circuit Court of Appeals at the time the decree was signed.

While the above proceeding was pending in the Federal Court a third investigation was started by the Commission on its own motion. This proceeding resulted in the Commission's order issued in July, 1930, establishing rates at Wichita agreeable to the distributing company. This rate was based on a city gate rate of forty cents (40c) to the distributing company.

In the proceeding in the Federal Court, and after a memorandum opinion had been handed down by Judge McDermott taxing all of the costs to the defendants, on motion of defendants to retax costs, a part was taxed to the plaintiff on the agreement of the defendants, in open court, to abide by that decision and use it as a starting point in future rate cases. (Dissent Judge Phillips, R. 48.)

Within four months from the time the final decree was signed by Judge McDermott and within four months from the time the Commission had agreed to abide by his decision, the proceeding, which is the basis of this controversy, came on to be heard, the same being an application by appellant for an increase in rates at El Dorado.

Little is said in the Kansas statute in regard to the nature of the proceedings before the Commission and the same have been established more by custom and the decisions of the courts than by statutory provision. The proceedings are most informal and the Commission is authorized to procure its information in any reasonable manner, it being left to the courts to correct any injustice which might result to either party.

In the case of *Railroad and Light Company* v. *Court of Industrial Relations,* 113 Kansas 217, 236, the Supreme Court of Kansas said:

> "It is not contemplated by law that proceedings before the Commission need be conducted with the formality required of judicial tribunals, nor that the facts of which the Commission may take note need conform to the law of evidence as understood by trained lawyers and judges. * * * We have said that the formalities of a judicial court need not be followed, but this is really no detriment to the parties; it facilitates the development of the facts; and it is because of the free and easy procedure permissible before the Commission that a trial *de novo,* not a mere appeal, is accorded in a judicial court from the orders of the Commission. So long as a judicial hearing *de novo* is provided, it is not very important just what sort of evidence is received by the Commission or how it is received, if the parties concerned are apprised of it."

In the more recent case of *City of Hutchinson* v. *Hutchinson Gas Company,* 125 Kansas 337, the Supreme Court was speaking as to what was necessary to be done in order for the Commission to establish a rate for a given town after its prior order concerning such town had been set aside by the courts. From the language used it is clear that the Supreme Court did not contemplate that everything should be gone over again and the strict rules of evidence applied. The Court said:

> "Appellee refers to the long interval before just and proper new rates can be lawfully put into effect, during which time any rates the utility sees fit to impose may be exacted. As to such situation, we can only remark that this court cannot function both

XII.

Plaintiff's application before the defendant Commission was dismissed and it was denied the relief prayed for solely on the ground that it had failed to justify its operating expenses as to the three items set out in Finding IX hereof. A motion for rehearing as provided by the Kansas statute was filed and overruled by the defendant Commission."

SPECIFICATION OF ASSIGNED ERRORS.

The errors assigned are as follows (R. 61-62):

I.

The court erred in denying the application of the plaintiff for a preliminary injunction.

II.

The court erred in the dismissal of plaintiff's bill of complaint and of said cause.

III.

The court erred in holding that the plaintiff recover nothing under its bill of complaint and that judgment be entered in favor of the defendants herein.

IV.

The court erred in refusing to make the findings of fact requested by the plaintiff (VII-A) as follows:

"The reasonableness of this rate was found and adjudicated by the Supreme Court of Kansas as to the City of Wichita, Kansas, in the case of *City of Wichita* v. *Public Service Commission*, said decision being reported in 126 Kansas 220; —— Pacific ——, and by this court in case numbered 1171-N, in Equity, final decree of which was entered in September, 1930. It is admitted by the pleadings that in this last mentioned proceeding, evidence was introduced showing that in November, 1928, the reasonable value of the system of the Cities Service Gas Company was more than $83,000,000.00 and

that the rate of 40 cents per thousand cubic feet for gas sold for domestic purposes to the several distributing companies served by the pipeline system would make a return to the pipeline company of less than eight per cent (8%) on such valuation."

V.

The court erred in its conclusion of law that the plaintiff had failed to exhaust its administrative remedy before the Commission.

VI.

The court erred in its conclusion of law that the complaint should be dismissed at the cost of the plaintiff.

Assignments Nos. I, II, III, V and VI all refer to the same legal question and will be discussed together.

Assignment No. IV will be discussed under a separate heading and will be first considered.

Summary of Argument.

The principal contention of the appellant in this cause is that the state of Kansas, through its regulatory body, the Public Service Commission, is without jurisdiction or authority to directly or indirectly fix the price which shall be charged by a pipe line company for gas sold in interstate commerce, notwithstanding the fact that such pipe line company may be affiliated with the distributing company to which it sells gas by reason of the capital stock of the pipe line company and distributing company being owned by a common holding company. It is our contention that the law, as announced by this court, in the cases of *Public Utilities Commission* v. *Landon*,

249 U. S. 236, and *Missouri* v. *Kansas Natural Gas Company*, 265 U. S. 298, was not changed by the decision of this court in the case of *Smith* v. *Illinois Bell Telephone Company*, 282 U. S. 133, and that the law of this case is the same as it was at the time this court held, in the case of *Missouri* v. *Kansas Natural Gas Company* with respect to this same pipe line company and this same Commission that the rates of the pipe line company were not subject to state regulation. Since the decision in *Missouri* v. *Kansas Natural Gas Company* many of the distribution companies which were at the time of that decision unassociated with the pipe line company have been acquired by the holding company which owns the capital stock of the pipe line company, or its subsidiaries, and this affiliation and the decision of this court in the case of *Smith* v. *Illinois Bell Telephone Company* have been considered by the Kansas Commission and the court below as changing the law previously announced by this Court and as having authorized and empowered said Commission to determine the reasonableness of the charges of the pipe line company engaged in interstate commerce and to limit the distributing company in its allowable operating expense for purchased gas to the rate which the Commission so finds to be reasonable. We contend that under the Constitution of the United States Congress alone has the power to regulate interstate commerce and that this is true whether the company engaged in interstate commerce sells its gas to a company with which it is affiliated or not. In the instant case the Cities Service Gas Company, engaged in interstate commerce, sells its gas to some distributing companies with which it is affiliated and to others with which it is not. It is our contention that the rule must of necessity be the same

in each instance and that the requirements of the Constitution admittedly existing before affiliation, are not changed by reason thereof and that the state Commission, which admits its lack of authority to proceed against the pipe line company engaged in interstate commerce, cannot indirectly accomplish the same purpose by undertaking to determine what price it should charge and by limiting affiliated distribution companies to the payment of that price.

ARGUMENT.

I.

Assignment of Error No. IV.

The proceedings which resulted in the decisions introduced in evidence before the Commission, and which were the basis of requested finding VIIa, are set out in appellant's bill under paragraphs IX, X, XI and XII (R. 14-18); are, in effect, admitted in appellee's answer under the same paragraph numbers (R. 35-37) and are recognized by the express admission of the Commission as follows:

> "The Commission will take notice of these decisions" (R. 64).

Admission is also made in paragraph XIII of appellee's answer (R. 38), as follows:

> "It is admitted that the defendant, Public Service Commission, should and did take notice of the decisions referred to and the respective records, but it is averred that the defendant, City of El Dorado, had and has no knowledge thereof."

The facts being undisputed we contend that the requested finding should have been made by the statutory court and that the majority of the court erred in refusing such finding for the reasons stated in the dissenting opinion of Judge Phillips (R. 48).

II.

As to Specified Errors Other Than No. IV.

All of the errors assigned, other than assignment No. IV, concern the application of the decision of this court in the case of *Smith* v. *Illinois Bell Telephone Company,* 282 U. S. 133, 75 Law Ed. 99, to this proceeding and to the peculiar facts and circumstances surrounding the natural gas industry generally.

A reading of the motion upon which the proceedings before the Commission were dismissed shows very clearly that at that time the Commission construed the Smith case as requiring a showing in every rate case as to the cost of gas to the supply company at the gate of each city where the distributing company and supply company are affiliated. Such a showing was not made before the Commission not only for the reason that it was impossible so to do but for the reason that the pipe line project of the Cities Service Gas Company, from which the City of El Dorado receives its supply, was not built up in that manner and could not continue its existence if zoning were resorted to, as an application of that theory would cause the price of gas at distant points to be so increased as to make its sale prohibitive. The facts as to the practice of the Cities Service Gas Company and similar natural gas transportation companies generally are set out in the affidavits of Thomas R. Weymouth (R. 80), Floyd C. Brown (R. 82), H. D. Hancock (R. 84) and Ed C. Connor (R. 86). When these affidavits were filed and their contents came to the knowledge of appellees they abandoned any idea they may have entertained up to that time as to the propriety of zoning the pipe line system of the Cities Service Gas

Company and determining a rate for each city thereon based upon the cost of rendering service to such city as distinguished from all other cities on the system and accordingly stipulated in the record that the system could not be zoned, which stipulation is embodied in finding No. XIII of the court below and is as follows:

> "At the hearing it was stipulated and agreed by the Commission through its counsel for the purposes of this hearing only, that the territory served by the pipeline company could not be segregated into separate zones for the purpose of fixing different costs of gas at the city gates in different zones" (R. 47).

The theory of ascertaining separate costs for separate cities having been abandoned by the appellees, the only questions remaining are as to whether or not the Commission, in a proceeding such as the application made by the Western Distributing Company for increased rates at El Dorado, has the right or authority to require a showing as to the reasonableness of the rates of a supply company engaged in interstate commerce from which it receives its gas for distribution and in this particular case as to whether or not the showing made by appellant before the Commission *prima facie* established the reasonableness of such city gate rate. It is our contention that the Smith case cannot be construed as disaffirming the many cases decided by this court in which it is held that the state cannot fix the price to be charged by a gas transportation company engaged in interstate commerce or carry its regulation to such an extent as to directly affect that price.

In the Smith case the court had under consideration a property which, of necessity, was an undivided unit

devoted to both interstate and intrastate business. One exchange handled both interstate and intrastate calls. There was but one set of poles, wires, instruments and operators; the time of all officers and employees was common to both branches of the business. As to the interstate business the Interstate Commerce Commission had jurisdiction; as to the intrastate business the Illinois Commission. Neither jurisdiction could infringe on the other. This made a separation of the physical property and earnings necessary. We quote from the decision as follows:

> "The separation of the intrastate and interstate property, revenues and expenses of the company is important not simply as a theoretical allocation to two branches of the business. It is essential to the appropriate recognition of the competent governmental authority in each field of regulation. In disregarding the distinction between the interstate and intrastate business of the company, the court found it necessary to pass upon the fairness of the division of interstate tolls between the American and Illinois companies. The court held that the division was reasonable and the appellants contest this ruling. But the interstate tolls are the rates applicable to interstate commerce, and neither these interstate rates nor the division of the revenue arising from interstate rates was a matter for the determination either of the Illinois Commission or of the court in dealing with the order of that Commission (page 148).
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> * * * * * * *
>
> The proper regulation of rates can be had only by maintaining the limits of state and federal jurisdiction, and this cannot be accomplished unless there are findings of fact underlying the conclusions reached with respect to the exercise of each authority. In view of the questions presented in this case the validity of the order of the state commission

can be suitably tested only by an appropriate determination of the value of the property employed in the intrastate business and of the compensation receivable for the intrastate service under the rates prescribed. Minnesota Rate Cases, 230 U. S. 352, 435. As to the value of that property, and as to the revenue and expenses incident to that business, separately considered, there should be specific findings. *Railroad Commission* v. *Maxcy*, 281 U. S. 82, 83 (page 149).

* * * * * * *

The appellants insist that this method is erroneous, and they point to the indisputable fact that the subscriber's station, and the other facilities of the Illinois Company which are used in connecting with the long distance toll board, are employed in the interstate transmission and reception of messages. While the difficulty in making an exact apportionment of the property is apparent, and extreme nicety is not required, only reasonable measures being essential (*Rowland* v. *Boyle*, 244 U. S. 106, 108; *Groesbeck* v. *Duluth, South Shore & Atlantic Railway*, 250 U. S. 607, 614) it is quite another matter to ignore altogether the actual uses to which the property is put. It is obvious that, unless an apportionment is made, the intrastate service to which the exchange property is allocated will bear an undue burden—to what extent is a matter of controversy. We think that this subject requires further consideration, to the end that by some practical method the different uses of the property may be recognized and the return properly attributable to the intrastate service may be ascertained accordingly" (pages 150-151).

The case was sent back to the statutory court, not to the Commission, for this separation and allocation.

The situation as to gas distribution properties is entirely different. There is no unit of property devoted to

both interstate and intrastate business. Not only in practice but by the repeated decisions of the Supreme Court of the United States, a clear line of demarcation exists between interstate and intrastate business without regard to whether or not the pipe line and distributing companies are in common or separate ownership. In the case of *Public Utilities Commission* v. *Landon*, 249 U. S. 236, 245, the court said:

> "But in no proper sense can it be said, under the facts here disclosed, that sale and delivery of gas to their customers at burner tips by the local companies operating under special franchises constituted any part of interstate commerce. * * *
> *Interstate movement ended when the gas passed into local mains.*"

In the subsequent case of *Missouri* v. *Kansas Natural Gas Company*, 265 U. S. 298, 308, 309, the same court said:

> "With the delivery of the gas to the distributing companies, however, the interstate movement ends. Its subsequent sale and delivery by these companies to their customers at retail is intrastate business and subject to state regulation. * * *
> The business of supplying, on demand, local consumers is a local business, even though the gas be brought from another state and drawn for distribution directly from interstate mains; *and this is so whether the local distribution be made by the transporting company or by independent distributing companies.*"

These decisions were reviewed and commented upon by this court in the most recent case of *East Ohio Gas Company* v. *The Tax Commission of Ohio*, 283 U. S. 465, decided May 18th, 1931, and the court again held

that interstate commerce ended when gas passed into local mains.

The matter having been many times decided by this Court further discussion would seem unnecessary. There being an actual division between interstate and intrastate business of appellant, that part of the Smith decision which requires such separation has no possible application. That case having been sent back to the statutory court primarily for this separation both as to value and earnings it is doubtful whether such action would have been taken by the court had that issue not existed and had the question before it been merely the relationship of the Chicago Company with the Western Electric Company.

Assuming that the case would have been sent back for findings as to the cost of service by the Western Electric Company to the Chicago Company we will briefly discuss that feature of the case and show its lack of application to the case at bar.

The Western Electric Company was an affiliated corporation manufacturing instruments but was not a public utility; not engaged in interstate commerce and not regulated nor subject to regulation. If, in the instant case, an affiliated company owned and operated a pipe mill and the El Dorado plant and other affiliated distribution systems purchased their pipe from this company, the Smith case would then be applicable and a showing would be required as to the *cost* of that pipe as distinguished from its actual *selling price*. The situation of the Cities Service Gas Company, however, is entirely different. It is engaged in interstate commerce; its rates and the issue of the right of the State of Kansas to regulate the same, have been directly before this

Court and the Court has held in regard to them that the state is without power to regulate:

> "That the transportation of gas through pipe lines from one state to another is interstate commerce may not be doubted. Also, it is clear that as part of such commerce, the receivers might sell and deliver gas so transported to local distributing companies free from unreasonable interference by the state. * * *"
>
> *P. S. C.* v. *Landon*, 249 U. S. 236.

The first paragraph of the syllabus in the case of *Missouri* v. *Kansas Natural Gas Company*, 265 U. S. 298, is as follows:

> "The business of piping natural gas from one state to another and selling it, not to consumers, but to independent distributing companies which sell it locally to the consumers, is interstate commerce free from state interference. *Pennsylvania Gas Co.* v. *Public Service Comm.*, 252 U. S. 23, distinguished. P. 307."

These decision hold that by reason of the national character of the business Congress alone has authority to act and that, in the absence of action by Congress, the state cannot interfere. The silence of Congress, when it alone has power to act, is said to be equivalent to a declaration that the business shall be free from regulation.

We quote further from the case of *Missouri* v. *Kansas Natural Gas Company*, *supra*:

> "In Minnesota Rate Cases, 230 U. S. 352, 396, Mr. Justice Hughes, speaking for the court, said: 'If a state enactment imposes a *direct burden* upon interstate commerce, it must fall regardless of Fed-

eral legislation. The point of such an objection is not that Congress has acted, but that the State has directly restrained that which in the absence of Federal regulation should be free.' The question is so fully discussed in that case, that nothing beyond its citation is required.

The contention that, in the public interest, the business is one requiring regulation, need not be challenged. But Congress thus far has not seen fit to regulate it, *and its silence, where it has the sole power to speak, is equivalent to a declaration that that particular commerce shall be free from regulation.*"

Our contention is that Congress having the sole right to act, and not having acted, its silence is equivalent to a declaration that existing pipe line interstate rates are reasonable and require no regulation and that the State has no more right to attempt to interpose its judgment as to what such rates should be or to attempt to determine the actual cost of gas at any particular city gate than if Congress had, in fact, acted and the rate had actually been fixed by the Interstate Commerce Commission or some other body having jurisdiction.

If the Interstate Commerce Commission in fact had jurisdiction and in fact had established the forty-cent (40c) city gate rate the courts would, of course, be bound to accept that rate as a starting point in the determination of just rates for distributing companies and the Kansas Commission would also be likewise bound. If a rate so established could not be questioned neither can the Commission, with Congress remaining silent, contend that it should have acted and that, in its absence, the Commission will take unto itself the authority not so exercised.

As stated in the decision above quoted, the dividing line between interstate and intrastate commerce cannot be affected by common ownership of both the transportation and distribution companies and neither can the principle so often declared by this Court that the rates of transportation companies in interstate commerce cannot be regulated by the State, be changed by any such consideration. As we have before stated, at the time the forty-cent (40c) city gate rate was established by the Kansas Commission there was no affiliation of transportation and distribution properties; they were not only separate, but antagonistic. The pipe line company, and some of the distributing companies having become affiliated, by reason of the economic necessity hereinbefore recited, the applicable principles of law cannot be thereby changed. We do not believe the Commission would now undertake, in a rate case brought by the companies owning the properties at Lawrence, Atchison, Leavenworth and other Kansas cities, to dictate to those companies the price that would be allowed in their operating expenses for gas purchased from the Cities Service Gas Company, the Commission knowing that such companies were not affiliated and had no possible control over the price they were paying. Could the situation possibly change by reason of the purchase of one or all of these companies by Cities Service Company? We most earnestly contend it could not.

If the Smith case is construed as contended for by the state it will permit to be done indirectly that which this Court has repeatedly held cannot be done directly.

That the business of transporting gas as it is transported by the Cities Service Gas Company is interstate commerce and that the Kansas Commission cannot regulate its city gate rates has twice been declared by this

Court. No question of applicability of a decision exists. The cases are in regard to this particular pipe line and this particular Commission.

Public Service Commission v. *Landon,* 249 U. S. 236.
Missouri v. *Kansas Natural Gas Company,* 265 U. S. 298.

The decisions in both of these cases have been reaffirmed by this Court since the decision in the Smith case.

East Ohio Gas Company v. *Tax Commission,* 283 U. S. 465.

The Commission itself will, we think, readily admit that it cannot proceed against the supply company and fix its rates. What then does the Commission now propose to do? Why does it want to find the cost of gas at the city gate? It does not attempt to conceal its purpose. On page 26 of its brief below its counsel state:

> "If an affiliated or holding company is being unjustly enriched by charges made to a subsidiary company (gate rate) the excess charges must be deducted from the expense items. * * * To allow it to exact from the subsidiary company an excessive charge for services rendered without taking such excessive charges into account in determining a proper rate (limiting the allowance to a gate rate fixed by the Commission) would destroy any attempt at regulation."

And again on page 18 where the Commission's attorneys attempt to justify its broken promise:

> "At that time the court had held that the Commission could not go into the pipe line valuation and

into the books of the holding company *and it was reasonably felt by the Commission and by its attorneys that they could not reach the pipe line company rate and that there was no way in which an unreasonable charge by the pipe line company could be avoided.*"

The intent of all this is that the Commission proposes to use the Smith case as its authority to regulate the very city gate rate which this court twice said it could not regulate. Truly it does not propose to do so in a proceeding against the pipe line and will now admit that it cannot do so. It will say, however, that it can do so in a proceeding against the distributing company. But by what trick of logic can it with one breath say the companies are different, and with the next base its entire case on the theory that by reason of their affiliation they are one?

To be entirely frank, the Commission must admit that it is attempting to do indirectly that which it cannot do directly. If the Smith case is to be so construed the prior cases which we have cited are in effect disaffirmed and a situation arises where a pipe line system, such as that of the Cities Service Gas Co., can sell its gas to a company not affiliated free from regulation, but if it chances to be affiliated with the distribution company in the next town, the State can tell such distribution company the price it can pay. Yet in each case the commerce is interstate.

It seems to us that a mere statement of the law independent of the Smith decision and a statement of the effect of that decision as contended for by the Commission is sufficient to overthrow the contention.

In our discussion up to this point we have urged our contention that the Smith decision did not change the

law as it previously existed or place any obligation upon a distributing company to show the reasonableness of the price it is paying to another company for gas at the city gate, whether such company be affiliated or not, it being our contention that whether such price is reasonable or otherwise is a matter within the exclusive jurisdiction of Congress which alone has the power to provide the machinery for determining the reasonableness or unreasonableness of such rate. In the course of this discussion we have called the attention of the court to the fact that notwithstanding the decisions of this court, prior to the decision in the Smith case, all to the effect that the state cannot regulate the price at which gas is sold by a company engaged in interstate commerce, we have, in two previous proceedings, and in order to satisfy public criticism, submitted to that issue being determined by the state courts of Kansas and by the District Court of the United States for the District of Kansas. In both of these cases the rate was found reasonable. The Kansas Supreme Court, in the case of *Wichita* v. *Public Service Commission*, 126 Kansas 220, 268 Pacific 111, decided June 9th, 1928, said:

> "The Wichita Gas Company buys its gas of the Empire Natural Gas Company, which owns the pipe line bringing the gas from the State of Oklahoma to Kansas. The Wichita Company pays the Empire Company 40 cents per M. cubic feet at the city gate. At one time this court was of the opinion the price was subject to regulation by the Public Service Commission. *State ex rel.* v. *Gas Co.*, 111 Kan. 809, 208 P. 622. This view was corrected by the Supreme Court of the United States. *Kansas Natural Gas Co.* v. *State ex rel.*, sub nom.

Missouri v. *Kansas Gas Co.*, 265 U. S. 298, 44 S. Ct. 544, 68 L. Ed. 1027. * * *

It is impossible to declare, on the meager record in this case, either agency or abuse of corporate privilege, in the relation between the Kansas gas companies and the parent organization. The result is, the sale of gas by the pipe line company to the gas company must be regarded as an instance of ordinary bargain between seller and buyer. All of the evidence, and there was much evidence on the subject, was that no gas was available to the gas companies at a price less than 40 cents per M. cubic feet."

Judge McDermott, now circuit judge, but at the time district judge in the case of *Wichita Gas Company* v. *Public Service Commission* in the District Court of the United States for the District of Kansas, First Division, in an opinion handed down May 28, 1930 (not reported), said (R. 19):

"It seems to me that the best test of the validity of the 40-cent rate is whether gas can be can procured for less. The record shows that a competing supply line comes into Wichita. It is looking for a purchaser for its gas. If the 40-cent rate is too high, the natural thing is to turn to its competitor. For nearly four years counsel for the defendants have realized the importance of the 40-cent rate in these rate matters. Counsel for the city advises the court that for two years they have endeavored to get an offer from the competing company at a lower rate. After the hearings before the master were completed in this case, the defendants directed my attention to the testimony of some officer of the competing supply company, in another case, in which he testified the competing company could sell for less. I continued further proceedings in this

case, and gave defendants all the time they asked to bring in some written offer from the competing supply company to the plaintiff. But put to the test, the competing company would make no offer of any kind. When, after four years assiduous effort, no one can be found that will offer to supply the needs of the plaintiff for less than 40 cents, it cannot be said that plaintiff is at fault in not paying less than that for its gas.

The 40-cent rate was established many years ago; since then conditions have changed materially; apparently inexhaustible fields of gas have been discovered in Texas, but many millions have been expended in development and construction. The 40-cent rate was one of the principal controversies in the state court litigation; the situation as it existed when the matter was litigated in the state court was substantially the same as when the rate order in question was made; the Supreme Court of Kansas affirmed the finding of the trial court that the 40-cent rate should be charged as an operating expense.

The plaintiff, in fact, pays 40 cents for its gas; it is conclusively shown that no lesser rate is open to it; there is no suggestion, in the record, of collusion or fraud; the evidence shows the rate to be reasonable. Under similar circumstances, the rate has been approved by the state courts; and I find no reason for sustaining the exceptions leveled at that rate."

The decree entered by Judge McDermott in the case cited was entered in September, 1930. Originally all costs in this case were taxed to the defendants, but, upon a motion to retax, it was urged on the part of the Commission and the City of Wichita that the Wichita Gas Company had profited by having had determined the issue as to the reasonableness of the city gate rate

and other issues and that it should, therefore, share in the costs of the proceeding. This motion was sustained, a memorandum opinion being at the time filed by Judge McDermott in which is recited the agreement of the Commission to abide by the decision in that case and use it as a starting point in future rate cases (R. 19 and 48). In consideration of the agreement of the Commission to abide by this decision, Judge McDermott taxed one-third of the cost of the proceeding to the Wichita Gas Company. Within four months thereafter the El Dorado case came on to be heard before the Commission and appellant, at that time relying upon the solemn agreement of the Commission made in open court, introduced in evidence both the decision of the Supreme Court of Kansas and the decision of Judge McDermott as evidence of the reasonableness of the 40-cent price then paid by the Western Distributing Company. The Commission at the time stated that it would take notice of these decisions.

Notwithstanding these decisions and the consideration which the Commission stated it gave them, it sustained the motion of its own attorney to dismiss the proceeding, the motion being sustained entirely on the authority of the Smith case, the presiding Commissioner stating (R. 78):

> "The Commission is of the opinion that, in view of the rules laid down by the Supreme Court in the Illinois Bell case, that the motion should be granted and it is granted. The application is denied."

The court below sustained the contention of appellees, both with respect to their insistence that under the law, as announced by this court, it devolves upon any dis-

tributing company asking for an increase in rates, without regard to the size of the town, the investment in the plant or any other consideration, to show the reasonableness of the price it pays for gas at the city gate (a complete hearing as to the pipe line) and with respect to its contention that the showing actually made before the Commission by the introduction of the previous adjudications and the showing that there had been no change in the situation was not sufficient and therefore that appellant had not exhausted its administrative remedy before the Commission.

The law under which the Kansas Commission functions was enacted in 1911 and has been in force ever since. Many cases have been heard by the Commission and many proceedings have been brought in the courts to set aside orders which the Commission has made. We supposed the law to have been well settled at the time this proceeding was heard by the court below that injunction proceedings brought to test orders of the Commission were trials *de novo* in which the proceedings before the Commission were entirely immaterial except as they might reflect upon the good faith of the party asking the courts for relief. We know of no decision of the Kansas courts holding that in a proceeding such as this the court is called upon to review the sufficiency of the record made before the Commission and on the contrary insist that all of the decisions of the Supreme Court of Kansas on the subject are to the contrary. Such a decision is the case of *Railroad and Light Company* v. *Court of Industrial Relations,* 113 Kansas 217, in which that court expressly held that evidence may be introduced in court which was not introduced before the Commission and concern-

ing facts which have transpired since the Commission hearing. In this case it is said:

> "Complaint is made because the trial court considered evidence of facts and conditions arising subsequent to the date of the order. This evidence showed the phenomenal and precipitate decline in the price of fuel oil from the time of the Commission's hearing in the autumn of 1920 to the time of the trial in the District Court in the summer of 1921. In August, 1920, the price was about $2.76 per barrel; in June, 1921, it had slumped to 65 cents per barrel. Was the admission of this evidence erroneous? A lawsuit over a rate order made by the Commission is a trial *de novo*. The issue is the reasonableness of the Commission's order. Any competent evidence is admissible. It was shown that the Commission's order was largely based, not upon the showing of financial results to the power company under the contract rates during the time they had been in force or for any considerable part of that period, but upon the forecast that the temporary high rates of 1920 would continue, and upon the estimate of the Commission's engineer that the future cost of fuel oil would be $2.50 per barrel. It is doubtless and necessarily true that public utility rates must be based, in part, upon estimates of future receipts and expenditures; but when the reasonableness of those rates is drawn in question it seems only fair to test the accuracy of the basic estimates and forecasts by whatever evidence is available. We can make no better answer to defendant's contention that this evidence was inadmissible than to quote from the opinion of one of the learned trial judges in one of the present cases (Judge McClure):
>
> 'This being a trial *de novo* either party could introduce evidence not offered before the Commission, but is such evidence to be limited to condi-

tions existing prior to or at the time of the hearing before the Commission? A rate is made for the future and is based upon past, present and assumed future conditions. The past or present prices of material and labor, or other operating costs, merely furnish criterion upon which a rate-fixing body may judge of future conditions. They are only of significance as they correctly foretell the future. If, after an order is made, the uncertainty of ascertaining future operating expenses becomes certain by reason of an experience under the rates ordered, why should not the prophecy give way to certainty? It may not be proper for a court to set aside an order of the Commission upon the ground that facts and conditions subsequently arising make the order unjust, but it seems almost irrational for a court of equity to totally disregard evidence of known and definite conditions, capable of correct mathematical ascertainment, and determine the reasonableness of a rate upon speculation or conjecture as to what operating costs might be when it has available actual experience under the order. If experience shows the adequacy of a rate, should a utility be permitted to say that a court called upon to determine such adequacy should close its doors to evidence of facts definitely ascertained by experience and indulge in *a priori* reasoning, thus limiting itself to a process of speculation rather than considering the facts as they actually exist. I think the evidence was properly admitted, not as being conclusive in the premises, but as furnishing an aid to the court, together with all other evidence, in determining the reasonableness of the order when made. This rule appears to have been followed in *Northern Pacific Ry. Co.* v. *North Dakota*, 216 U. S. 579; *Knoxville* v. *Water Co.*, 212 U. S. 1, and numerous other cases, and its apparent fairness appeals to this court.'

It is argued that such evidence is only admissible where the rate complained of is one of confiscation.

We have yet to learn that an impairment of a contract right (except where justified by the police power) is not a species of confiscation (12 C. J. 929-931). * * *

The Commission may gather its facts in the most informal way, and may and should avail itself of all reports and data gathered by its own staff of engineers, statisticians, and accountants; but it is only fair that all such facts, data and reports, wheresoever gleaned, should be presented in public so that the parties to be affected by the Commission's determination may show, if they can, by cross-examination or otherwise, that such data and reports are either inaccurate, fallacious or incomplete, or not of controlling significance. In no other way can the Commission itself be sure that it is doing approximate justice to those concerned. We have said that the formalities of a judicial court need not be followed, but this is really no detriment to the parties; it facilitates the development of the facts; and it is because of the free and easy procedure permissible before the Commission that a trial *de novo,* not a mere appeal, is accorded in a judicial court from the orders of the Commission. So long as a judicial hearing *de novo* is provided, it is not very important just what sort of evidence is received by the Commission or how it is received, if the parties concerned are apprised of it. As was said in *The State ex rel.* v. *Mohler,* 98 Kan. 465, 472, 158 Pac. 408:

'If this power is abused, the courts are open to the aggrieved party, if not by some statutory review, then by the extraordinary and prerogative remedies of injunction or mandamus.'"

That such a proceeding is a trial *de novo* is recognized by Judge Hopkins (R. 56, 59), Judge Hopkins having formerly been a member of the Supreme Court of Kansas and being familiar with its decisions.

We admit the rule that parties must come into a court of equity with clean hands and are willing to admit that in proceedings before the Commission an applicant should conduct those proceedings in absolute good faith and not wilfully withhold any evidence with the idea of subsequently introducing such evidence before the court. In this proceeding, however, there is no charge of bad faith on the part of appellant and we contend not only that there can be no such charge but, on the contrary, that appellant had every reason, at the time the proceedings before the Commission were heard, to assume that the Commission would act in good faith and recognize the agreement it made of record in the United States District Court in the Wichita case and would abide by the decision of that court as to the reasonableness of the city gate rate in all future proceedings.

The situation being as we have outlined and there being no charge of bad faith or unclean hands, we believe the court below erred in refusing to consider appellant's bill and its plea of confiscation on the sole ground that appellant had failed to exhaust its administrative remedy before the Commission.

Judge Phillips, in his opinion on the motion to dismiss (R. 51-52), and in his opinion in amplification of conclusion of law No. 3 (R. 49), states that in his view of the law it was incumbent upon appellant to show that its contract with the supply company was such a one as the parties would make if dealing with each other at arms' length and in the absence of any common ownership of stock. It is our contention that we have fully complied with the views expressed by Judge Phillips in the evidence introduced before the Commission which is

recited in findings VII and XI (R. 44 and 46) to the effect that at the time the rate was established there was no affiliation of the companies by stock ownership or otherwise; that the rate had remained the same since the affiliation; that it was originally and after careful investigation established by the Commission; that no other source of supply existed; that no gas had ever been offered at a cheaper rate; than an attempt had been made to procure local gas without success; that the same rate was paid by cities in nowise affiliated, such as Lawrence, Leavenworth and Atchison, Kansas, and that there had been no material change in the situation since the decisions in the Wichita rate cases by the Supreme Court of Kansas and the United States District Court, both of which were introduced in evidence and considered by the Commission.

In our previous discussion we have given only casual consideration to the first two items enumerated in finding IX (R. 46) for the reason that both items could be eliminated without affecting the result of the proceeding. It is our contention that these items are merely items of operating expense which could be disallowed by the Commission if it determined them to be unreasonable but that they are not such matters as would justify the Commission in dismissing the proceeding and denying relief any more than such justification would exist as to any other items of operating expense with the proof of which the Commission might not be satisfied.

The reasonableness of each of these items was litigated in the Wichita rate case both in the Supreme Court of Kansas and the United States District Court. In regard to the first item the Kansas Supreme Court said:

> "Henry L. Doherty & Company maintain a corps of experts in engineering, research work, and other

activities, who render valuable services to gas companies by way of engineering advice, legal advice, accounting and auditing service and assistance in matters of finance. One and three-fourths per cent of the gross revenue of the gas company is paid to Henry L. Doherty & Company for this service. There was no testimony that the compensation was either improper or extravagant, and it was admitted that it was paid in good faith."

The United States District Court said:

"Doherty and Company are paid 1¾% of the gross receipts for certain services rendered and detailed by the master. The law is settled by the decisions of the Supreme Courts of the United States and of Kansas concerning the 4½% contract between the American Telephone and Telegraph Company and its subsidaries. The record and the master's findings bring this case within that law. It is contended that the work done by Doherty and Company duplicates the work done at Kansas City. The record is to the contrary. It is contended that the services by Doherty and Company are paid for as they are rendered, and that the 1¾% payment is profit. The record is to the contrary. In fact, the undisputed evidence shows that the 1¾% was arrived at by ascertaining the actual cost of the services rendered to all distributing companies and apportioning it according to gross sales. Furthermore, the record shows, without dispute that the necessary operating expenses are less than they would be if the Wichita plant was operated as an independent unit."

As to the second item the Supreme Court of Kansas said:

"Doherty companies in Kansas and nearby states are managed from a regional general office (Gas

Service Company at Kansas City). Other groups of Doherty companies are similarly managed. The offices of the general manager, the chief engineer, and the legal department, for this region are maintained at Kansas City, Missouri. The general ledgers of the Kansas gas companies are kept there. All general office expense, executive salaries, general clerical salaries, legal expense, and general traveling expense, are borne by the Kansas City office, and the proper sum is charged to each gas company. The referee found on abundant evidence that the sums paid by the three Kansas companies were reasonable and proper, and allowed them."

The United States District Court said:

"Certain of the company's necessary work is done from Kansas City by the Gas Service Company, which does the same work for a number of other distributing companies. The method should make for economy; the expenditures are conceded. It is claimed that all of these expenses should be disregarded, because some charitable contributions enter into them. The evidence discloses that such contributions are negligible, and the amount prorated to Wichita so small that their elimination would have no bearing on the result."

The adjudication of both these matters was included in the agreement hereinbefore referred to wherein the Commission stated that if part of the costs were taxed to the Wichita Gas Company it would abide by Judge McDermott's decision and use it as a starting point in future rate cases.

We believe the Commission would have recognized its agreement in the instant case had it not been for the

Smith decision, on the authority of which the contention was made that it was not sufficient to show, as had previously been shown, that the expense of Henry L. Doherty & Company, without profit, was allocated to the companies receiving its service on a gross revenue basis and that the expense of The Gas Service Company, without profit, was allocated to the companies receiving its services on a meter basis but that on the authority of the Smith case it was necessary to show the actual services rendered by each of these organizations to any particular property and the cost to such organization of rendering such service. The applicant declined to make such a showing because of its impossibility and because of its contention that the Smith case could not be construed as requiring such a showing. As above stated, it had been shown in previous cases that both the New York organization and the Kansas City organization operated without profit and were maintained solely for the benefit of the companies receiving their respective services and that their actual expenses only were allocated to the respective properties receiving such service. The Smith case involved an allocation of expense between interstate and intrastate business, the necessity for which is absent in the instant case, and also involved inter-company relations which were carried on for profit, the reasonableness of which profit was brought in question.

The showing made by the Western Distributing Company before the Kansas Commission consisted of its own undisputed evidence to the effect that it was operating under rates established by the Commission in 1920; that the present fair value of its property was the sum of $288,442.00; that for the year ending November 30,

1930, its gross earnings were the sum of $197,394.64 with actual expenses of $283,049.07, leaving a deficit of $40,654.42 in which sum it failed to make its actual and necessary operating expenses. The court below, while not finding the amount in which appellant failed to make its operating expenses, did find, in finding No. X (R. 46) that the items of expense representing payments to Henry L. Doherty & Company and the Gas Service Company could be eliminated and that applicant would still fail to make its operating expenses by an amount greatly in excess of the total of said items, such total being $9,424.54.

There can, therefore, be no question of insufficient returns and resulting confiscation nor any contention that appellant was not entitled to relief from the court below except on the ground that it failed to make a showing as to the reasonableness of the price it was paying an affiliated company engaged in interstate commerce for gas at the city gate in addition to the showing which it did make and which appellant now contends was sufficient to establish a *prima facie* case.

We respectfully submit that as a matter of law the Kansas Commission had no authority to investigate the reasonableness of the price charged by the Cities Service Gas Company, engaged in interstate commerce; that appellant was not required to make any showing before it as to the reasonableness of that price; that the Smith case has no application to the facts of this case; that appellant conducted its proceedings before the Kansas Commission in absolute good faith and that the court below erred in its conclusion that appellant had not exhausted its administrative remedy before the Commission; in

denying appellant's application for a preliminary injunction; in dismissing the bill and denying the relief sought therein.

ROBERT D. GARVER,
Kansas City, Missouri,
ROBERT STONE,
Topeka, Kansas,
Solicitors for Appellant